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VIA Internet submission to: www.regulations.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Definition of Fiduciary – RIN 1210-AC02

Dear Sir or Madam:

The Alternative & Direct Investment Securities Association ("ADISA"),[1] a member association focused on alternative investments, appreciates the opportunity to comment on the Department of Labor's (the "Department") proposal to update the definition of an investment advice fiduciary for purposes of Titles I and II of ERISA as well as to amend several related prohibited transaction exemptions ("PTEs"). The various amendments are referred to herein as the "Proposal".

I. ADISA's Focus: Alternative Investments

ADISA's membership includes retail and managing broker-dealers, Securities and Exchange Commission ("SEC") and State registered investment advisers and firms that sponsor, manage and distribute various alternative investments, including REITs and BDCs, interval funds and energy programs. As a broad-based member association, ADISA seeks to engage in productive dialogue with legislators and regulators with oversight of its members' activities, with the goal of providing objective information about the marketplace for alternative investments.

ADISA members generally focus on alternative investments, especially those made available in the retail space, including individual retirement accounts ("IRAs"). Alternative investments provide returns that are generally uncorrelated to public stock and bond markets. They may be sold via public registration statements or privately placed, but they are typically not traded on any exchange. They may in turn also hold assets that are not market traded – e.g., real estate, energy assets and debt. Alternative investments generally have a lengthy holding period and are not easily sold or transferred in the period prior to a liquidity event. This fulfills an important need in portfolio allocation and is particularly useful in light of the long-term nature of retirement savings.[2]

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[1] ADISA is the largest association of the retail direct investment industry in the United States. ADISA has approximately 5,000 members who employ over 220,000 investment professionals, together serving the interests of more than 2 million investors throughout the country. Direct and alternative investment programs serve a critical need in the creation and ongoing management of diversified investment portfolios.
[2] There is also the widely understood "illiquidity premium," which refers to the additional return offered by a non-exchange traded investment over that of one that can be quickly converted to cash.

Perhaps more importantly, these investments are not "portfolios" for the investor/client – rather, they are elements of a portfolio, adding important diversification benefits. Put another way, alternative investments are not in and of themselves "advised portfolios" but rather are intended as and in fact sold as component parts providing important diversification benefits. They do not themselves make up "advised" portfolios. Because of their typically less liquid and long-term holding qualities, these products are well suited to a commission model of compensation for those who recommend them.

II. The Department's Proposed Rulemaking

The Department has proposed to amend the regulation defining when a person renders "investment advice for a fee or other compensation, direct or indirect" with respect to any moneys or other property of an employee benefit plan, for purposes of the definition of a "fiduciary" in the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). The proposal also would amend the parallel regulation defining for purposes of Title II of ERISA, a "fiduciary" of a plan defined in Internal Revenue Code (Code) section 4975, including an individual retirement account. The Department also published proposed amendments to Prohibited Transaction Exemption 2020-02 (Improving Investment Advice for Workers & Retirees) and to several other existing administrative exemptions from the prohibited transaction rules applicable to fiduciaries under Title I and Title II of ERISA.[3]

III. ADISA Position on the Proposal

The Department's Proposal involves a significant revision to the definition of "investment advice fiduciary," one that will impose fiduciary status on financial service providers engaging in a wide range of transactions. ERISA provides that "any person who renders 'investment advice for a fee or other compensation, direct or indirect' is an investment advice fiduciary, regardless of whether they have direct control over the plan's assets, and regardless of their status under another statutory or regulatory regime."

The Proposal answers the question of whether broker-dealers provide "advice" when making recommendations to retirement accounts, including IRAs, with a resounding "yes." This transformation by the Department of brokerage activity, whether one-time in nature or otherwise, into "advice" places a host of requirements on broker-dealers in order for them to receive variable compensation resulting from those recommendations. This would be particularly true with regard to broker-dealers that make recommendations of alternative investments to IRAs for commission-based compensation. The basis for this approach is the Department's belief that retirement investors have trust in and rely on persons with whom they have relationships, such that activity traditionally viewed as "sales" is transformed into advice if constructed or phrased (or delivered) in a certain way by a firm or person that engages in making investment recommendations as a regular part of its business.[4]

For reasons discussed in more detail below, ADISA does not support the approach fashioned by the Department. In ADISA's view, it improperly mixes the "trust and confidence" nature of a true fiduciary relationship with the reasonable reliance on expertise element that is a hallmark of a brokerage recommendation. By imbuing what in many cases is a relationship based on expertise, one

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[3] See Retirement Security Rule: Definition of an Investment Advice Fiduciary (RIN 1210-AC02). See also Application No. D-12057 (Proposed Amendment to PTE 2020-02); Application No. D-12060 (Proposed Amendment to PTE 84-24); Application No. D-12094 (Proposed Amendments to PTE 75-1, 77-4, 80-83, 83-1, 86-128).

[4] The Department's approach is that a communication is a "recommendation" if it is one that, "based on its content, context, and presentation, would reasonably be viewed as a suggestion that the retirement investor engage in or refrain from taking a particular course of action." The Department's Proposal also requires that the party engage in making investment recommendations on a "regular basis" as part of its business.

subject to long-standing and recently upgraded principles of federal regulation, the Department puts the broker-dealer model of serving clients into the same category as the fiduciary relationship that pertain between an investment adviser and its clients, without regard for the differences between the two and without regard for the consequences. In particular, this approach will likely have an undesirable impact on the marketplace wherein broker-dealers recommend alternative investment products and programs to IRA holders.[5]

1. <u>The Proposal Improperly Equates Brokerage Activity with Investment Advice.</u>

The Department's approach effectively ignores the legally and practically different nature of the relationship between broker-dealers and their customers, on the one hand, and investment advisers and their clients, on the other. While much is said by the Department about the perceived lack of clarity in the marketplace between the two models, the distinction is important and, in our view, both recognizable and recognized. The distinction lies at the heart of how Congress separated investment advisers and broker-dealers under the federal securities laws, ensuring that the latter did not come within the definition of investment adviser under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), where the advice given was solely incidental to their security sales efforts.

The Department's motivating belief is, simply put, that "sales equals advice." It rejects the purported dichotomy between a mere "sales" recommendation, on the one hand, and advice, on the other, in the context of the retail market for investment products. Citing recent regulatory developments from both the SEC and NAIC, financial service industry marketing materials, and the industry's comment letters reciting the guidance they provide to investors, the Department avers that "sales and advice typically go hand in hand in the retail market."

A. <u>Brokerage is Not Always "Advice"</u>

The SEC had occasion, in the process of adopting Regulation Best Interest ("Regulation BI"), to address and elaborate on the principle that broker-dealers may give "advice" in the course of their business activities without that subjecting them to the Advisers Act and the fiduciary status that such entails. According to the SEC, "[t]he broker-dealer exclusion shows, on the one hand, that at the time the Advisers Act was enacted Congress recognized broker-dealers commonly provided some investment advice to their customers in the course of their business as broker-dealers and that it would be inappropriate to bring broker-dealers within the scope of the Advisers Act because of this aspect of their business." [6]

At the same time, the SEC reiterated the statutory language that governs the exclusion, making it clear that the exclusion only applies where "broker-dealer advisory services… are solely incidental to the broker-dealer's regular business as a broker-dealer… and when the broker-dealer receives no special compensation [therefor]." Importantly for these purposes, the SEC made it clear that the exclusion does not depend on the quantity or importance of the advice and expertise offered by the broker-dealer:

> The quantum or importance of investment advice that a broker-dealer provides to a client is not determinative as to whether or

[5] The need for alternatives over the long term is illustrated by the following: in the 10-year period from 1999-2009, the generic 60% equity/40% bond portfolio after fees returned absolutely 0% while the heavily managed Yale, Harvard, and Stanford portfolios with alternatives performed from 135% to 198% in total, while the S & P 500 lost 35%.

[6] Commission Interpretation Regarding the Solely Incidental Prong of the Broker- Dealer Exclusion to the Definition of Investment Adviser, Advisers Act Release No. 5249 (June 5, 2019).

> not the provision of advice is consistent with the solely incidental prong. Advice need not be trivial, inconsequential, or infrequent to be consistent with the solely incidental prong. Indeed…broker-dealer investment advice can be consequential even when it is offered in connection with and reasonably related to the primary business of effecting securities transactions.[7]

In a similar vein, the U.S Court of Appeals for the Fifth Circuit stated in its decision vacating the Department's 2016 fiduciary rule that this purported "equivalence" is simply not the case.[8] To briefly quote from that opinion: "[t]ransforming sales pitches into the recommendations of a trusted adviser mixes apples and oranges." ADISA does and will not liken those who sell financial securities to those who sells cars and the like, for such an analogy overlooks and downplays the duties placed on broker-dealers both by regulation and under common law when making recommendations to clients. As was testified to by multiple parties in the Department's recent hearings on the Proposal, the difference between sales and advice is real and provides a meaningful basis for not treating all sales as advice.

This point about the difference between "sales" and "advice" is particularly relevant to the world of alternative investments. Recommendations relating to alternative investments typically do not invoice wholesale decisions on where or how to hold assets or how the investor's overall portfolio should be shaped to meet the investor's goals. The issue on the table, typically, is whether a particular alternative investment would likely add critical elements such as sustained income or diversification to an existing portfolio; if the purchaser is a retirement account, such as an IRA, the principal added elements are issues such as whether the investment is in keeping with the account's long term and/or tax-advantaged nature. The hallmark of advice, on the other hand, in the way that the term is understood and used by investors and investment professionals alike, is portfolio management.[9]

B. Consequences of Treating Brokerage Recommendations as Advice.

The process whereby a broker-dealer recommends an alternative investment is imbued with the sales element, since it is a single or isolated sales process relative to a specific product, which takes it out of being portfolio management. Pulling product recommendations into the investment advice fiduciary standard will have several harmful consequences, as discussed below.

i. Increased Costs

There is the matter of cost associated with complying with the Proposal and, in particular, PTE 2020-02. As ADISA noted in reference to the Department's prior fiduciary tule proposal, any approach that subjects financial advisers to additional costs will result in having those costs passed along to those seeking this assistance or, worse, result in an unwillingness to provide services to IRA holders without higher minimums or higher fees.

Making it more expensive for retirement savers using IRAs is simply not justifiable where the existing regime provides protections to clients of broker-dealers and investment advisers. ADISA acknowledges that ERISA takes a more restrictive approach to protecting covered plans and accounts

[7] Ibid.

[8] Chamber of Commerce of the USA v. US Dep't of Labor, No. 17-10238 (5th Cir. Mar. 15, 2018)

[9] "Stockbrokers and insurance agents are compensated only for completed sales ('directly or indirectly'), not on the basis of their pitch to the client. Investment advisers, on the other hand, are paid fees because they 'render advice.' The statutory language preserves this important distinction."

than the disclosure-focused federal securities laws, but the SEC's recent efforts in connection with its adoption of Regulation BI to enhance protections for clients of broker-dealers (and, for that matter, investment advisers) has created a more substantive set of protections than existed previously. It should be relied upon to the greatest extent possible by the Department in lieu of its proposed, top-to-bottom reform proposal.

ii. Pressure on the Broker-Dealer Model.

The Department's approach will, in our opinion, make it extremely difficult for broker-dealers to serve IRA holders using the traditional commission model. The Department's proposed approach would make broker-dealers into investment advice fiduciaries subject to a common, uniform standard with investment advisers. This common standard is, from the standpoint of broker-dealers, more stringent than the SEC's recent Regulation BI and, for all intents and purposes, is not tenable. The Department's rationale for this is that "conflict-ridden" recommendations made by broker-dealers can and should be mitigated or eliminated by subjecting them to a uniform fiduciary standard.

The entire purpose underlying the careful crafting of Regulation BI by the SEC was to address, as mandated by Dodd-Frank,[10] whether a common standard should apply as between broker-dealers and investment advisers. Through the adoption of Regulation BI, the SEC responded to Congressional and public interest by effectively raising the bar for broker-dealers but without subjecting them to a pure fiduciary duty. The SEC clearly understood that unconditionally applying a fiduciary standard to broker-dealers would likely diminish or even spell the end of the commission approach to compensation that is a hallmark of the broker-dealer model. Regulation BI exists because of the SEC's judgment, as required by Congress, that a single fiduciary standard for broker-dealers and investment advisers was (i) not necessary; and (ii) not workable.[11]

The Department makes several efforts to dispel this concern, stating that the SEC "has adopted regulatory standards for broker-dealers that are based on fiduciary principles of care and loyalty also applicable to investment advisers under the Advisers Act." The Department goes further in this regard, moreover, saying that "holding broker-dealer representatives to fiduciary standards at the State level does not impair access to their services."[12]

The intended implication of the Department's language is that there is no real issue associated with having broker-dealers comply with a single, fiduciary-based standard. These pronouncements do not square, however, with the SEC's understanding of this point, as expressed during the adoption of

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[10] Dodd Frank Wall Street Reform and Consumer Protection Act, Pub. Law. No. 111 – 203, 124 Stat. 1376 (2010) ("Dodd-Frank")

[11] As stated by the SEC in its adopting release for Regulation BI: "[T]here are key differences between Regulation Best Interest and the Advisers Act fiduciary standard that reflect the distinction between the services and relationships typically offered under the two business models…. In addition, the new obligations applicable to broker-dealers under Regulation Best Interest are more prescriptive than the obligations applicable to investment advisers under the Advisers Act fiduciary duty and reflect the characteristics of the generally applicable broker-dealer business model."

[12] This is a reference to the fact that the Commonwealth of Massachusetts implemented a regulation that subjects broker-dealers to the same conduct standard as investment advisers. The Commonwealth's Supreme Judicial Court upheld the regulation as a "permissible extension" of the standard of care that applies to traditional investment advisers to "new-age broker-dealers…" Robinhood Financial LLC vs. Secretary of the Commonwealth, 492 Mass. 696 (2023). In its decision, the Court noted that the Secretary of State deemed the rule necessary "to protect investors confused by the increasingly blurred line between broker-dealers providing investment advice and investment advisers."

Regulation BI. The requirements imposed by the applicable PTE, which details the elements of the "Impartial Conduct Standard" that persons seeking to comply with the PTE need to satisfy, go well beyond the elements established by Regulation BI. By themselves, these requirements threaten to limit if not extinguish the ability of broker-dealers to serve IRA holders. The Department's suggestion that broker-dealers can comply with these fiduciary standards when imposed by States is also not borne out by practical experience - the Robinhood decision focused on the Secretary's adoption of the regulation, not the ability of a broker-dealer to actually comply with its requirements. These two points are addressed in turn.

iii. The SEC's Regulation BI and PTE 2020-02

At bottom, as clearly stated by the SEC, Regulation BI is a "best interests" standard, not a "fiduciary" standard, drafted to respond to its understanding that there is a need for a differing regime for broker-dealers. As the SEC stated at the time: "[w]e have declined to subject broker-dealers to a wholesale and complete application of the existing fiduciary standard under the Advisers Act because it is not appropriately tailored to the structure and characteristics of the broker-dealer business model (i.e., transaction-specific recommendations and compensation), and would not properly take into account, and build upon, existing obligations that apply to broker-dealers, including under FINRA rules."

The requirements of Regulation BI are superseded by and in important ways are not compatible with the requirements of PTE 2020-02 and the "Impartial Conduct Standard" imposed thereby. Under PTE 2020-02, investment advice fiduciaries must provide investment advice that is "at the time it is provided, in the Best Interest of the Retirement Investor." In turn, "Best Interest advice" (1) reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, and (2) does not place the financial or other interests of the Investment Professional, Financial Institution or any Affiliate, Related Entity, or other party ahead of the interests of the Retirement Investor, or subordinate the Retirement Investor's interests to their own."

PTCE 2020-02, as currently in effect, requires fiduciaries seeking to rely on it for the receipt of variable compensation to:

- acknowledge their fiduciary status in writing[13]
- disclose their services and material conflicts of interest[14]
- adhere to Impartial Conduct Standards requiring them to:
    - investigate and evaluate investments, provide advice, and exercise sound judgment in the same way that knowledgeable and impartial professionals would

[13] "[T]he Financial Institution must provide a written acknowledgment that the Financial Institution and its Investment Professionals are providing fiduciary investment advice to the Retirement Investor and are fiduciaries under Title I, the Code, or both when making an investment recommendation."

[14] This description must include "the amount the Retirement Investor will directly pay for such services and the amounts the Financial Institution and Investment Professional receive from other sources, including through Third-Party Payments. If, for example, the Retirement Investor will pay through commissions or transaction-based payments, the written statement must clearly disclose that fact."

- act with undivided loyalty to retirement investors when making recommendations
- charge no more than reasonable compensation and comply with Federal securities laws regarding "best execution"
- avoid making misleading statements about investment transactions and other relevant matters

• adopt policies and procedures prudently designed to ensure compliance with the Impartial Conduct Standards and mitigate conflicts of interest that could otherwise cause violations of those standards

• document and disclose the specific reasons that any rollover recommendations are in the retirement investor's best interest

• conduct an annual retrospective compliance review.

There are several aspects of compliance with the PTE that would pose particular difficulties for any broker-dealer who is made an investment advice fiduciary in connection with a one-time recommendation in return for commission-based compensation. In particular, the obligation to "charge no more than reasonable compensation" is a standard that, while drawn from ERISA, will likely lead to claims against any investment advice fiduciary that earns anything more than the lowest amount possible in connection with any recommendation. As explored below, measuring a one-time investment advice fiduciary's compensation against these standards leaves room for broker-dealers who make alternative investments available to IRA holders potentially liable, after the fact, for receipt of compensation that is otherwise higher than that charged on routine transactions.

The Department states that its standards "should not be read as somehow foreclosing the Investment Professional and Financial Institution from being paid on a transactional basis" and that "Financial Institutions and Investment Professionals are entitled to receive reasonable compensation fairly disclosed for their work, as long as they do not subordinate the Retirement Investor's interests to their own and have appropriate policies and procedures to safeguard against imprudent or disloyal advice."[15] While this language appears as though it would extend protection to all forms of commission-based compensation, the language of this standards plus the nature of the commission paid on sales of less liquid, long holding period alternatives gives ADISA significant pause. The standard might serve well enough in the context of traded securities purchased on a commission basis, but not well with respect to many if not most retail alternative products and programs as well as alternative investments that are privately placed.

It is ADISA's experience that commissions typically associated with the sale of alternative investment products are relatively large. The relatively higher commissions associated with such less liquid alternative investment products are ascribable in large part to the fact that the client's holding period for such investments is much longer, such that the investment amount will therefore be tied up

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[15] To quote the Department, "[c]ertainly, in many cases, it is in the Retirement Investor's best interest to receive advice from Investment Professionals that are compensated through commissions incurred on a transactional basis, rather than as part of an ongoing fee-based relationship (for example, pursuant to an advisory relationship subject to a recurring charge based on assets under management). In such cases, the fact that the Investment Professional received a commission for their services is not inconsistent with the principles set forth herein." In many cases, a one-time commission as a front load can be significantly less expensive in the long term than even a relatively low fee recurring over the same time period.

for a longer period than an exchange-traded instrument. It is one thing for the Department to confirm that the commission model is not put out of business by the PTE, however, and another thing altogether to ascribe to the view that a higher commission can and will pass muster under the standard set by ERISA and carried forward by PTE 2020. It is ADISA's concern, however, that a higher commission level can be and/or will be equated with putting the broker-dealer or associated person's interest "ahead of" the client's and making the commission itself "unreasonable."

This notion that a higher commission product may be deemed to be outside of the "reasonable compensation" standard and thus seen as subordinating the client's interest to that of the financial adviser or his or her firm is bound up with the idea that there are lower (or no) commission products available to investors that are (or are believed to have) the same or substantially similar performance qualities as those of the higher commission products in question. In effect, despite the Department's contention that the rule will not force broker-dealers to select the "best" product on the market, it will be argued by the plaintiff's bar and others that a broker-dealer's choosing the higher commission product is and was a *per se* breach of the standard because the "best" product cannot ever be the more expensive product, compensation-wise.[16]

ERISA's reasonable compensation standard makes sense where there is either discretionary authority lodged with the broker-dealer, thus shielding its decisions from client oversight or pre-approval, or where the broker-dealer is providing advice that is advice in the sense of the understood meaning of that word and not just sales support and discussion. Applying it to a one-time sale of an investment security or program to a brokerage customer unfairly lumps in sales-driven activity into the advice context and tees up the commission element for criticism and more.

iv. State Efforts to Create a Single Standard have not Been Tested

The approach taken by the Secretary of State of the Commonwealth of Massachusetts, which is cited by the Department as supporting the principle that a common fiduciary standard is workable for broker-dealers, does not establish that a single standard is in fact workable. The regulation promulgated by the Secretary of State in Massachusetts, which imposed a uniform fiduciary standard for broker-dealers and investment advisers, was upheld by the Commonwealth's highest court in the context of a challenge by Robinhood, an on-line brokerage platform. The language used by the Court in upholding the Secretary's rulemaking was addressing a narrow context that is not what is found in the traditional brokerage world involving the recommendation of alternative investments to IRAs. More importantly, it simply did not address how a single standard would work in the more traditional world of alternative investments recommended by broker-dealers.

According to the Court's opinion in Robinhood, "[c]ertain broker-dealers [had] expanded the types of services and products they offered to retail customers, 'often provid[ing] advice and mak[ing] recommendations about securities transactions and investment strategies.'" The Court noted that these broker-dealers "also changed their marketing, [as] financial services firms began to use a variety of titles to describe their personnel, such as 'financial advis[er],' 'financial consultant,' and 'advis[er].'" In addition, according to the Court, "some broker-dealers' compensation models morphed, such that,

[16] This is a very different question than whether a product is the "best" product, which the Department says is not the standard: "it should be noted that this Best Interest standard also does not impose an unattainable obligation on Investment Professionals and Financial Institutions to somehow identify the single 'best' investment for the Retirement Investor out of all the investments in the national or international marketplace, assuming such advice were even possible at the time of the transaction."

rather than charging commissions, some broker-dealers draw revenue from "payments for order flow."[17]

In the Court's view, the key element in the Secretary's approach was its sense of investor confusion over the role of the broker-dealer in the transaction.[18] According to the Court, "investors [increasingly and] mistakenly believed that the broker-dealers had a fiduciary obligation equal to investment advisers to act in their customers' best interests… and this mistake resulted in investor harm." The Court rejected the idea that traditional differences in how broker-dealers and investment advisers counseled against a single standard, finding that this argument "fails to consider the extensive record relied on by the Secretary showing that the industry has strayed from the traditional model for the provision of investor services, as broker-dealers have changed their offerings, marketing, and compensation models." Ultimately, the Court concluded, "the Secretary permissibly adapted the standard of care required of these new-age broker-dealers, who have themselves adopted new business models inconsistent with their traditional roles and prior industry norms, to carry out his charge under MUSA to protect investors…"

There is a large difference between addressing the amended (if not radically changed) broker-dealer model that the Court had in front of it (as the Secretary of State described it), and the traditional commission-based brokerage sale that is involved in the area of retail alternative investments. Just as importantly, the Court acknowledged but did not assess the assertion made by Robinhood and the industry to the effect that the single standard was unworkable for broker-dealers. The opinion notes the argument, made during the rulemaking process, that a single standard would "effectively restrict investor choice and access to products and services by increasing the cost of advice." Rather than subject the argument and the Secretary's response to a close analysis, however, the opinion simply quoted the Secretary's statement that "[w]hen preserving 'choice' means preserving the option to choose opaque, poorly understood products that are sold via heavily conflicted advice, the benefits of such 'choice' are illusory." It even added an additional quote from the Secretary, highlighting the Secretary's assertion that the new rule would "enhance[] the quality of advice in the transactional, episodic brokerage model without imposing any new ongoing obligations upon those providing it."

ADISA's view is that effectively lumping all broker-dealer transactions into the investment advice fiduciary standard due to "changed" business models in parts of the industry and any resultant investor confusion is not justified and is simply not workable. Subjecting all broker-dealer recommendations to the "reasonable compensation" standard will chill a broker-dealer's willingness to recommend any type of investment security that carries a high (or higher than average) commission. Whether a product meets the reasonable compensation standard will prove to be an item of endless discussion and, assuredly, litigation. While some broker-dealers models may, for policy reasons, justify the application of a higher (fiduciary) standard, the recommendation of retail alternative investments to IRA holders in return for a sales commission simply does not warrant the same treatment.

v. <u>Regulation BI does not Employ a "Reasonable Compensation" Standard</u>

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[17] The Court described this as "a method of transferring some of the trading profits from market making to the brokers that route customer orders to specialists for execution…"

[18] As noted in the opinion, the SEC had adopted the Regulation Best Interest "notwithstanding the Secretary's concerns that the general obligation would fail to protect investors who were confused by the differences between investment advisors providing investment advice and recommendations and broker-dealers who also gave investment advice and recommendations." The Court pointed out that the Secretary had "criticized the proposed general obligation and urged the SEC instead to adopt a 'strong uniform fiduciary standard' that would impose on broker-dealers a fiduciary duty to customers equal to that of investment advisers."

The Department asserts in passing that, as amended, PTCE 2020-02 does not extend materially far beyond Regulation BI. It must be noted, however, that there is no analog in Regulation BI to the “reasonable compensation” touchstone found in ERISA and made applicable through PTE 2020-02. While the Department characterizes the new fiduciary standard as straightforward and logical - as set forth in the PTE, the Best Interest standard “allows Investment Professionals and Financial Institutions to provide investment advice despite having a financial or other interest in the transaction, so long as they do not place their own interests ahead of the interests of the Retirement Investor or subordinate the Retirement Investor's interests to their own.” The gloss added to this statement by the Department – “that in choosing between two investments offered and available to the investor from the Financial Institution, it is not permissible for the Investment Professional to advise investing in the one that is worse for the Retirement Investor but better for the Investment Professional's or the Financial Institution's bottom line” – will, unfortunately, lead to the mis-application of the standard to the sale of alternative investments and lead in turn to significant difficulties and potentially undue and unwarranted liability for broker-dealers.

Again, the crux of ADISA’s concern is the relatively large size of commissions paid in regard to retail alternatives, in comparison to commissions paid on more liquid securities (and particularly those traded on exchanges). For reasons discussed above, the commission amount is simply larger on the sale of a retail alternative, owing to the less liquid nature of the investment – the holding period will be long (or at least longer), and the commission amount or level reflects that fact. Although, as the Department states, “Financial Institutions and Investment Professionals are entitled to receive reasonable compensation fairly disclosed for their work,” this likely will leave the relatively larger size or amount of commissions for retail alternative programs as outside of the realm of reasonableness and thus indicative of the broker-dealer’s having “subordinat[ed] the Retirement Investor's interests to [its] own.”

Put another way, the “reasonable compensation” standard, when applied to products with significant but explicable if not defensible commission levels, will be used to demonstrate that a higher commission product or program is simply not “reasonable” as a result. As evidence of this mindset, we look to the discussion in the Department’s release that touches on “leveling” compensation: ”it is not enough merely to pay Investment Professionals the same percentage of the Financial Institution's compensation for a recommended investment product, as for other products, if the Financial Institution receives more compensation from recommending that product rather than other products. In such cases, the ‘level’ compensation percentage in effect directly transmits the Financial Institution's conflict of interest to the Investment Professional, as the Investment Professional's compensation is increased in direct proportion to the profitability of the investment to the firm.”

There is no specific requirement in Regulation BI that the compensation paid to a broker-dealer in connection with a covered recommendation be “reasonable” in order to satisfy the regulation’s requirements. Rather, while cost is an element to be considered (whether it’s the cost of the product or the cost of the commission is not specified), it is not a separately analyzable element as it is under a “reasonable compensation” standard. Under Regulation BI, the analysis is multi-faceted, taking into account everything from the nature of the product to the circumstances of the investor, and much that is in between. As stated by the SEC staff, “[u]nder Reg BI, broker-dealers must obtain and analyze enough customer information to have a reasonable basis to believe that the recommendation is in the best interest of the particular retail customer.” There is no overarching requirement applicable to broker-dealer compensation, as would be the case under the rule and ERISA.

FINRA Rule 2121, moreover, which applies to broker-dealers who are member firms (which is practically all of the brokerage industry), provides that “if a firm “acts as agent for his or her customer in

any such transaction, s/he shall not charge the customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefor." FINRA has determined that "it shall be deemed a violation of Rule 2010 and Rule 2121 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable."[19] The nuanced definitional elements provide significantly more room for a larger commission amount or level to be justified; in addition, the so-called "mark-up" rule "is not applicable to the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price."

vi. Costs are Addressed under Regulation BI

Seeking to avoid a singular focus on selling compensation is not, however, tantamount to a desire to ignore cost, both of the product as well as of the compensation attached to selling it.[20] Cost, which can include compensation payable to the selling broker(s), is a factor in the Regulation BI analysis. In the adopting release, the Commission noted that, "in addition to requiring broker-dealers to understand the potential risks and rewards associated with the recommendation, we are also expressly requiring them to understand and consider the potential costs associated with a recommendation.... [C]ost will always be a salient factor to be considered when making a recommendation." The SEC went out of its way to note that this is a new, express element of broker-dealer regulation, stating that the requirement that the broker-dealer understand and consider costs "is a distinct enhancement over existing reasonable basis suitability obligations, which do not expressly require this consideration."

At the same time, however, the SEC recognized—and emphasized — that "cost is one important factor among many factors." It provided additional guidance "regarding the importance of weighing and considering costs in light of other relevant factors and the retail customer's investment profile potential risks, rewards—and now costs—of the recommended security or investment strategy..." and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers based on that understanding."[21]

There are two aspects of the "reasonable basis" component of the care obligation under Regulation BI that bear on this point and that make Regulation BI a suitable source for guidance on how to handle costs in the context of a recommendation to an IRA or other retirement account.

One, a broker-dealer must have "a reasonable basis to believe that the security or investment strategy could be in the best interest of at least some retail customers." The SEC noted that what would constitute reasonable diligence, care, and skill "will vary depending on, among other things, the complexity of and risks associated with the recommended security or investment strategy and the broker-dealer's familiarity with the recommended security or investment strategy. While every inquiry will be specific to the particular broker-dealer and the recommended security or investment strategy,

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[19] FINRA Rule 2010 provides that a member firm, in the conduct of its business, "shall observe high standards of commercial honor and just and equitable principles of trade."

[20] Interestingly, behavioral finance research indicates that investors are not particularly sensitive to fees or commissions so much as they are concerned with bottom-line results.

[21] According to the SEC, this aspect of Regulation BI "is intended to incorporate and build upon broker-dealer's existing 'reasonable-basis suitability' obligations and [relates] to the broker-dealer's understanding of the particular security or investment strategy recommended, rather than to any particular retail customer."

broker-dealers generally should consider important factors such as the security's or investment strategy's investment objectives, characteristics (including any special or unusual features), liquidity, volatility, and likely performance in a variety of market and economic conditions; the expected return of the security or investment strategy; as well as any financial incentives to recommend the security or investment strategy."

Two, a broker-dealer must "have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks and rewards associated with the recommendation." In addressing this requirement, the SEC articulated that, under this standard, a broker-dealer could not have a reasonable basis to believe that the recommendation is in the "best interest" of the retail customer if the broker-dealer put its interest ahead of the retail customer's interest.[22]

To address feedback from commenters on Regulation BI as proposed, the Commission provided further interpretations and guidance regarding the application of the Care Obligation, and in particular, what it means to make a recommendation in a retail customer's best interest and not place the broker-dealer's interest ahead of the retail customer's interest. Specifically, recognizing that "a facts and circumstances evaluation of a recommendation makes it difficult to draw bright lines around whether a particular recommendation would meet the Care Obligation," the Commission provided further guidance on how a broker-dealer could have a "reasonable basis to believe" that a recommendation is in the best interest of its retail customer and does not place the broker-dealer's interest ahead of the retail customer's interest:

- The SEC made it clear, as regards costs, that recommendations of the lowest cost security or investment strategy, without consideration of other factors, could violate Reg BI. In that vein, it noted that "a recommendation may be considered to be in a retail customer's best interest when viewed in the context of the retail customer's portfolio even if seemingly not in a retail customer's best interest when viewed in isolation (e.g., inclusion of what otherwise might be seen as a risky investment in the portfolio of a risk-adverse customer, such as including hedging instruments in a conservative portfolio)." According to the SEC, the importance of each factor, and which factors to consider, will depend on the facts and circumstances of each recommendation, as well as the specific security or investment strategy.

- The SEC also stated that a broker-dealer generally "should consider reasonable alternatives, if any, offered by the broker-dealer in determining whether it has a reasonable basis for making the recommendation." The SEC explained that this approach "would not require a broker-dealer to analyze all possible securities, all other products, or all investment strategies to recommend the single 'best' security or investment strategy for the retail customer, nor necessarily require a broker-dealer to recommend the least expensive or least remunerative security or investment strategy." "Instead," it wrote, "when a broker-dealer recommends a more expensive security or investment strategy over another reasonably available alternative offered by the broker-dealer, the broker-dealer would need to have a reasonable basis to believe that the higher cost is justified (and thus nevertheless is in the retail customer's best interest) based on other factors (e.g., the product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and

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[22] To that end, the SEC incorporated into Regulation BI a requirement that broker-dealers have a reasonable basis to believe that the recommendation "does not place the financial or other interest of the broker-dealer ahead of the interest of the retail customer." This was intended to make clear that, "while a broker-dealer typically will have some interest in a recommendation, the broker-dealer cannot put that interest ahead of the retail customer's interest when making the recommendation."

potential benefits, volatility and likely performance in a variety of market and economic conditions), in light of the retail customer's investment profile."

Accordingly, under Regulation BI, a broker-dealer could recommend a more expensive security or investment strategy "if there are other factors about the product that reasonably allow the broker-dealer to believe it is in the best interest of the retail customer, based on that retail customer's investment profile." In its view, a broker-dealer "could recommend a more remunerative security or investment strategy if the broker-dealer has a reasonable basis to believe that there are other factors about the security or investment strategy that make it in the best interest of the retail customer, in light of the retail customer's investment profile." The SEC went on to state that it continue[s] to have the view that "a broker-dealer generally should consider reasonably available alternatives offered by the broker-dealer." In its view, such a consideration is an inherent aspect of making a 'best interest' recommendation and would be a "key enhancement" over existing broker-dealer suitability obligations.

- In the context of complex products, moreover, the SEC stated that when broker-dealers are recommending complex or costly products, they should first consider whether less complex or costly products could achieve the same objectives for their retail customers. "In terms of conducting such an evaluation, a broker-dealer does not have to conduct an evaluation of every possible alternative, either offered outside of the firm (such as where the firm offers only proprietary or other limited range of products) or available on the firm's platform." The SEC indicated that it "appreciated" the impracticality and potential impossibility of such a comparative evaluation, "particularly where the firm offers numerous different products, many of which may have similar strategies but with other varying characteristics, including cost structures, that may apply differently based on the particular retail customer."

- Furthermore, the SEC stated that it recognizes that "different products are rarely perfectly equal, and that differences will be both quantitative and qualitative in nature." A broker-dealer will not be required to recommend the single 'best' of all possible alternatives that might exist, "in part because many different options may in fact be in the retail customer's best interest." The SEC concluded by noting that it is sensitive to concerns that "this determination, to the extent it can be made at all, may be judged in hindsight even though Regulation BI applies at the time of the recommendation."

- Finally, SEC noted a need for flexibility in in regard to complex products. "While we stress the importance of understanding the potential risks, rewards, and costs associated with a recommended security or investment strategy, as well as other factors depending on the facts and circumstances of each recommendation, we do not intend to limit or foreclose broker-dealers from recommending complex or more costly products or investment strategies where the broker-dealer has a reasonable basis to believe that a recommendation could be in the best interest of at least some retail customers and the broker-dealer has developed a proper understanding of the recommended product or investment strategy."

It is for these reasons that ADISA takes issue with the Department's decision to place broker-dealers under a common fiduciary standard when providing information to IRA holders and others about a given investment. The standards are very different, such that the use of a single standard will lead to additional costs (a subject that is explored again below) and a very incompatible set of applicable standards. More than any other factor, the requirement that an advice fiduciary receive only "reasonable compensation" threatens to drag broker-dealers who sell lower liquidity, higher commission alternative investment programs to IRAs into difficult and potentially expensive litigation

over whether the compensation payable on such instruments or programs meets the newly applicable "reasonable compensation" standard.[23] It is one thing to see the advent of new business models that threaten to engender investor confusion and seek to attach additional requirements to the operation of such models, and quite another to seek to apply those same new rules to the traditional sales of alternative investments to IRAs with a substantial commission.

2. The Proposed Rule Will Curtail the Use of Alternatives By Small Balances Savers

ADISA believes that the Proposal will put significant negative pressure on broker-dealers who use the commission model of compensation. This will have two dramatic and related impacts: it will substantially diminish if not eliminate the willingness and the ability of broker-dealers to serve smaller IRAs; and it will cause broker-dealers to be unwilling to make recommendations of alternative investment products to IRA holders. While there is substantial disagreement over the so-called "advice gap" that the industry believes will occur as a result of putting a fiduciary duty on broker-dealers, it is highly likely that it will if nothing else reduce if not eliminate the willingness of broker-dealers to serve the retirement community with alternative investment products and programs. Even if we assume that broker-dealers will continue to serve small(er) balance savers and even if we assume that new types of programs have arisen and will continue to arise to serve small balance IRA holders who require advice,[24] the proposed rulemaking will limit the access of such small balance retirement savers to programs and products that they need to provide diversification and income and other important portfolio elements.

A. The Advice Gap

It appears that, despite several statements to the contrary, the Department is moving in the direction of eliminating the commission model for persons serving IRA holders and other retirement savers. Reducing the availability of advice and expertise to small balance savers is likely to have a detrimental impact on their ability to meet their goals, as broker-dealers are and traditionally have been an important source of knowledge and expertise (and, as discussed below, investment products) to smaller balance savers. If the costs of serving accounts simply increases as a result of the Proposal, then if nothing else broker-dealers will curtail or cease providing services to smaller balance IRAs and similar retirement accounts. This will create, to use a controversial phrase, an "advice" gap.

A number of industry groups, including ADISA, raised the issue of access in connection with the Department's 2016 adoption of the Fiduciary Rule (and have raised the issue again in response to the Department's new proposed rulemaking). The Department seeks to cast doubt on the decreased access issue, making and/or repeating criticisms of studies relied on by the industry and critics of the now-abrogated Fiduciary Rule in arguing that the Rule would diminish the availability of advice and create a larger wealth gap as a result. Since the 2016 Fiduciary Rule was never fully implemented, it is hard to say that the studies in question were able to measure its true impact. That said, ADISA continues to believe that any regulatory initiative that results in reducing the availability of access to investment expertise and to alternative investments will impact small balance savers more than any other group of retirement savers.

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[23] The Department takes the position that it is not creating new bases for lability. After noting that it is not proposing to require a contract for investment advice to IRAs (as it did in 2016), it states "neither the existing PTE 2020-02 nor the proposed amendment creates any new causes of action or requires Financial Institutions to provide enforceable warranties to Retirement Investors."

[24] Using vast Equifax data, during the Great Recession and its aftermath, the ratio of advised to non-advised IRA assets in accounts for those making less than $100k/year grew by over 20%, indicating the value of investment advice during harder economic times (Oliver Wyman, 2015).

The SEC itself, in adopting Regulation BI, noted the concerns raised on this point:

> [W]e believe (and our experience indicates), that this approach [of adopting a single fiduciary standard] would significantly reduce retail investor access to differing types of investment services and products, reduce retail investor choice in how to pay for those products and services, and increase costs for retail investors of obtaining investment recommendations. We have also declined to craft a new uniform standard that would apply equally and without differentiation to both broker-dealers and investment advisers. Adopting a 'one size fits all' approach would risk reducing investor choice and access to existing products, services, service providers, and payment options, and would increase costs for firms and for retail investors in both broker-dealer and investment adviser relationships.[25]

It is hard to deny that making the commission-based approach more expensive and more likely to lead to potential litigation and liability will likely diminish the number of broker-dealers willing to serve IRAs. This is particularly true with regard to smaller balance IRAs, where the cost of serving such accounts is an important consideration in the setting by broker-dealer firms of account minimums, fee schedules and the like. Selling products and securities via a commission often is a more affordable way to provide access to investments, as it avoids subjecting the saver's entire portfolio to an investment advisory fee. Small balance savers will be avoided by firms that want to try and charge commissions to the extent that the increased compliance costs requires them to raise fees or impose higher asset minimums.

Given the intense dispute over whether changes to the ERISA fiduciary standard is likely to have an impact on access to advice and expertise by retirement savers, it is appropriate to quote from the Fifth Circuit's 2018 opinion in the Chamber of Commerce case:

> Throughout the financial services industry, thousands of brokers and insurance agents who deal with IRA investors must either forgo commission-based transactions and move to fees for account management or accept the burdensome regulations (and heightened lawsuit exposure required by the BICE contract provisions). It is likely that many financial service providers will exit the market for retirement investors rather than accept the new regulatory regime. Further, as DOL itself recognized, millions of IRA investors with small accounts prefer commission-based fees because they engage in few annual trading transactions. Yet these are the investors potentially deprived of all investment advice as a result of the Fiduciary Rule, because they cannot afford to pay account management fees, or brokerage and insurance firms cannot afford to service small accounts, given the regulatory burdens, for management fees alone.[26]

It may not be possible and it is certainly not a good use of time to try and parse the back-and-forth on this issue and determine which studies have it right (and which either have it wrong or were just premature in their measuring process). What counts is that there is a consequence to any approach

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[25] Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86031, 84 FR 33318 (June 5, 2019).

[26] The SEC echoed these concerns in 2019: "Our concerns about the ramifications for investor access, choice, and cost from adopting either of these approaches are not theoretical. With the adoption of the now vacated Department of Labor Fiduciary Rule, there was a significant reduction in retail investor access to brokerage services, and we believe that the available alternative services were higher priced in many circumstances."

that would effectively rule out a popular and cost-effective way of delivering value to retirements savers.

B. Detrimental Impact on Access to Alternatives

Brokers are in the business of selling securities. Unless they are also registered as investment advisers, they provide advice appurtenant thereto, but not for special compensation and only incidental to their sales of securities. Broker-dealers occupy a unique place on the investment landscape – they provide advice if at all in relation to the securities that they are selling or transacting in and their distinct approach is what warranted having a separate set of statutory and regulatory provisions that apply to and govern their conduct.

i. Negative Impact on Small Balance Savers Generally

Much of the alternative investment landscape is populated with products and programs that entail a commission for program or product sellers. These commissions may be payable up front or over time, but their receipt is limited to firms that are registered as broker-dealers. If and to the extent that broker-dealers making recommendations of alternative investment products are defined under the proposed rule as investment advice fiduciaries and required to comply with PTCE 2020-02 to receive compensation, the concerns outlined above will come into play and make it risky and expensive for such firms to recommend alternatives to IRA holders. With particular regard to investment products that have larger sales commissions because they relate to long term, less liquid programs and securities; therefore, tempering the ability of broker-dealers to earn these commissions will effectively limit or eliminate the ability of such firms to recommend alternative investments to smaller balance IRAs.

Eliminating or restricting a valuable (and likely necessary) set of portfolio instruments to such accounts, particularly where the commission approach is a potentially more economical approach to the acquisition of securities and other assets by IRAs, will not advance the ability of small balance savers to meet their goals. Several years ago, ADISA pointed out in testimony on the Department's proposed Fiduciary Rule that reducing the availability of advice and expertise to small balance savers was likely to have a detrimental impact on their ability to meet their goals. ADISA did not draw a specific link between the limited availability of the commission approach and the use of alternative investment products by such accounts, but the connection is clear - making the commission model less available will limit the willingness and ability of broker-dealers to efficiently serve smaller balance IRAs and, importantly, limit the availability of alternative investment products to IRAs holders generally.

ii. Impact on Distinct Communities; New Advice Platforms

There is both a demographic element as well as an investment aspect to this consequence. The demographic makeup of the small balance saver universe strongly suggests that the Department's efforts will have a disproportionate impact on less affluent and often poorly served communities. Small balance savers are made up in material part by elderly savers and persons who are relatively new to the workforce or to the practice of saving for retirement generally. It also includes persons from historically disadvantaged communities, such as persons of color and other minorities, who have only started saving in the recent past or have not been able to put aside significant amounts to date. Causing access to expertise and reducing the availability of the more cost-effective commission model will likely have a dramatic and negative impact on these communities, particularly in light of studies showing the benefits

of accessing advice to the goal of building wealth.[27] Alternative investments can provide income and insulation from market volatility, which can be of particular use to small balance savers who cannot necessarily absorb market fluctuation. Since alternative investments typically come with a commission and are often sold by broker-dealers, these changes will effectively deny the benefits of alternatives to just the smaller end of the retirement saver spectrum

Against this backdrop of limited access and services, the Department offers the idea that such a development should not be troubling since other forms of advice that are more "conflict free" are coming in the marketplace. To quote the Department, "financial services firms already were moving toward more fee-based advice models, considering flatter compensation models, and integrating technology," and "smaller savers may use one or more of the following: target-date funds; receiving advice directly from investment firms using in-house funds and investments; hourly engagement or subscription-based firms; and robo-advice." In the Department's view, the revised rule "would accelerate these types of innovations for the benefit of plan and IRA investors."

This emphasis on these other approaches to the provision of investment advice to retirement savers and elsewhere is notable, but also consequential. There is good reason to welcome new means of providing advice. But it needs to be said that these new technologies are not fully tested nor are they as necessarily conflict free as the Department otherwise suggests (just look at the rise of gamification in brokerage apps introduced to encourage investors to trade the markets; such apps typically do not have a human interface). And the use of model portfolios – a hallmark of "robo-advice" - can lead to herd like behavior, thus putting participants at risk of disaster when their models do the same thing for all investors at the same time.[28]

iii. Disparate Effect on Alternative Investments.

Even if these newer forms of advice turn out to be good for retirement savers, however, there is an important aspect to their operation that is of particular relevance to alternative investments. To wit, these new services do not now and are not in the foreseeable future likely to make true alternative investments available to their clients. Alternative investments are often sold by broker-dealers with a commission structure, given their illiquid and long term nature; they are not a natural "fit" for these alternative means of delivering advice to retirement savers. Accordingly, small balance savers using these new methods will find it nearly impossible to access these important (if not vital) investments. So, they are choices, certainly, but they cannot bring the benefits that current approaches provide when it comes to access to true alternative investments.

Fees and expenses matter, especially since investment outcomes are uncertain and not capable of meaningful guarantees or other assurance. At the same time, lower fees do not necessarily come with a higher likelihood of success. Earlier cost studies cited by the Department in 2016 and again in connection with the Proposal, which were used to try and assign a "price tag" to the cost of conflicted advice (to use the Department's phrase), were at best incomplete and possibly completely misleading. For example, in looking at the cited analysis that "found" that broker-sold fund shares "cost" more than

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[27] A study by the Hispanic Leadership Fund (2021) indicated that the 2016 DOL Fiduciary Rule, had it gone into effect, would "have the most adverse effects on Blacks and Hispanics, reducing their accumulated IRA savings by approximately 20% over 10 years...an approximately 20% increase in the wealth gap attributable to IRAs..."
[28] Robo-advice is particularly limited; an academic study showed that robo-advice is typically based only on an investor's self-reported risk preference--not wealth, age, income or other important factors, and that human advice surpassed robo-advice, all fees included. J.P. Harrison and S. Samaddar, "Who Is Better at Investment Decisions: Man or Machine?" *The Journal of Wealth Management* 23, no. 3 (2020): 70-84.

non-broker-sold shares and ascribed to the difference the concept of "loss," that analysis ignored the impact of advisory (account) fees for investors who held non-broker-sold funds in advisory and similar accounts.[29] To the extent that the purported "savings" to come from the Department's Proposal are overstated if not illusory, much of the impetus for the changes being proposed goes away to the same extent, leaving just the costs discussed herein.

Before leaving this topic, moreover, it is important to understand just how powerful the diversification benefits of alternative investments can be when placed in a portfolio of securities and other traded assets. Studies show that diversification raises a portfolio's expected returns and reduces its risks. Thus, the negative impact of not having a diversified portfolio may in fact outweigh any expense differentials purportedly associated with "conflicted" advice. It is a nice headline to say that retirement savers can be spared billions of dollars of losses, but if the impact of reducing these costs is that retirement savers lose access to important portfolio diversifiers, the benefits touted by such headlines are not necessarily real (or at least not nearly as complete as one would want).

3. Conclusion

ADISA does not want to stand in the way of progress and does not object to the Department's desire to make more transactions subject to an appropriate standard, particularly in regard to rollover decisions. Retirement savings are critical to a broad swath of the population and ensuring that savers get quality help at a good price with these savings is an important goal.

While well-intentioned, the way chosen by the Department is not, in our judgment, the correct way to do this. The broker-dealer commission-based model, which can be quite advantageous for smaller balance savers to use, will be disadvantaged by the Proposal and may disappear from use in the IRA context. This will, as we have shown, have deleterious effects on small balance savers of all types, and particularly those who are older savers as well as newer entrants to the workforce and those savers from communities that have not been able to save for retirement. To the extent that the disappearance of the broker-dealer model will make it more difficult for the small balance saver to employ a cost effective model when getting help with investing their savings, it will make it far harder for those same investors to access alternative investments. While ensuring that costs are appropriately wrung from the system (or at least managed), is an important goal, ensuring that small balance savers have access to important diversification benefits from such investments is perhaps even more important to helping them meet their goals.

Under the circumstances and the aforementioned reasons, ADISA believes the Proposal should be re-worked to eliminate these consequences. In that regard, we believe that the Department could take a page from the SEC's approach to Regulation BI and consider carving out from the "reasonable compensation" standard the types of compensation arrangements applicable to less liquid, alternative investment products and programs. ADISA is not suggesting that the commissions charged on such products, etc., are not "reasonable" – rather, it is that such commissions, even if fully justifiable and reasonable in *toto*,[30] may be subject to a hindsight analysis issue that will make broker-dealers highly

[29] We note that the study was later amended by one of its authors, who determined that the study as initially published neglected to consider performance differentials and failed to asset-weigh the investments' gains. As corrected, the difference was made more or less moot (1% to 0.18%).

[30] Many of alternative investments are subject to FINRA limitations on compensation applicable to programs distributed through member firms. The various States have also applied minimum purchaser criteria as well as important concentration and related limits on such programs that can be relied on in lieu of a specific ERISA-derived standard.

unwilling to recommend them if they are deemed advice fiduciaries when doing so. A carve out for certain types of compensation otherwise permitted under applicable laws and regulation could be inserted into PTE 2020-02.

Moreover, while the Department rejected the suggestion that its newly amended rule have an exclusion for sophisticated investors, there is little in the Department's rationale for not doing so that holds much weight. Sophisticated investors can use the expertise offered by broker-dealers as part of the sales process and keep clearly in mind their role and status when considering the information and recommendation(s) they provide. Including a carve out for investors who meet a wealth, sophistication and/or expertise standard would help ensure that parties who do not require certain protections are free to act for and engage in the transactions that they want to.

In employing either or both of these suggested carve out approaches, the Department could use as a model the SEC's approach to certain types of conduct, etc., in Regulation BI, where the agency focused on compensation which varies based on the advice given (such as commissions, markups and markdowns, loads, revenue sharing, and Rule 12b-1 fees). As the SEC saw it, reasonably designed policies and procedures adopted by broker-dealers "should include mitigation measures that depend on the nature and significance of the incentives provided to the associated person and a variety of factors related to a broker-dealer's business model... and the complexity of the security of investment strategy involving securities."

ADISA certainly stands ready—as always—to assist further as might be needed. We appreciate the fine work the Department and others do on behalf of the nation, and we also appreciate the opportunity to contribute in any way you deem appropriate.

Sincerely,

Michael Underhill
President

cc: Drafting committee--ADISA's Legislative & Regulatory Committee (John Grady and Catherine Bowman, co-chairs)